CHAPTER III

THEORY OF INTERNATIONAL VALUES

International trade is exchange between nations while home trade is concerned with exchange within a nation. In the economic sense of the word a nation implies a group of producers within which labour and capital freely circulate. The agents of production will move from trade to trade, from industry to industry according to the returns expected from it; there is no barrier for their free circulation. Within any particular country, the value of goods tend to be determined by the cost of production. There is within the country a normal relation between value and cost and if this relation happens to be disturbed, the industrial agents will move from the region where they receive the smaller return to those where they receive the larger return.

The free movement of the industrial agents and the operation of free competition are reduced or retarded as between one nation and another. Capital and labour move from trade to trade within the same nation. But they do not easily migrate beyond that nation. People prefer to invest their capital and savings in the development of the productive resources of their own country although they could obtain a higher return in a foreign country. Similarly labour is immobile; it is generally rooted in the land of its birth and not tempted to migrate by the prospect of higher wages

So far we have assumed trade between two countries in two commodities. But actually many nations take part in international trade and many commodities are exchanged. To rightly understand the nature of International Trade, it is necessary to constantly bear in mind its great perplexity and the operation of numerous factors, such as the impediments to transport, the combination of dealers on each side, the imposition of customs duties, etc. The effect of these several factors may be to increase or lessen the share of gain from international trade of a particular country: the ratio of interchange may move in its favour or against it, that is, for a given quantity of its exports it may or may not get the same quantity of import goods as before. Still the fundamental condition that determines international values is, to use Mill's expressions, "Equation of International Demand", the ratio of exchange depends on the comparative intensity of demand on each side, always of course operating within the limits set by Comparative Cost.

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in a foreign country, for as Adam Smith says, "Of all sorts of luggage man is the most difficult to transplant".

The obstacles to the free movement of labour and capital which produce the conditions called the 'International' are 1) geographical distance 2) differences in political institutions, 3) differences in language, religion and social customs, 4) differences in tariff, currency system and commercial legislation. The immobility of the industrial agents brought about by these factors distinguish international trade from home trade and render a separate theory of international trade quite necessary. Within a country there is a normal relation between value and cost; whenever this relation is disturbed capital, labour and organization move freely from place to place and bring about an equality in the rates of wages, in the returns on capital and in the earnings from organization. But the agents of production do not move at all or move only with difficulty from one country to another and this immobility interferes with the action of free competition and causes serious differences between value and costs in the several trading countries.

How then are the values of goods that enter into International trade determined? The formula which governs international prices is called the Law of Comparative Cost, and is thus stated by Cairns.

"The one condition at once essential to and also sufficient for the existence of International trade is a difference

in the comparative as distinguished from the absolute cost of producing the commodities exchanged. The ratio of exchange in the case of commodities which are the subject of international trade will lie somewhere within the limits imposed by comparative costs. Within these limits the actual ratio will be determined by the comparative intensity of demand on each side."

It is usual to state the theory of comparative cost without the introduction of money and under simple hypothetical conditions. It is assumed that there are two countries A and B, each producing the same commodities only and both capable of export. Units of productive power in the countries are generally taken in terms of days' labour.

1) Absolute advantage:-

Country A has an advantage over country B in the making of both the commodities, viz., cloth and corn, but the advantage is greater in the one commodity than in the other.

In A 8 days' labour will make 8 yards of cloth or 8 bushels of corn.

In B 8 days' labour will make 4 yards of cloth or 6 bushels of corn.

If each produces for itself then 16 days' labour will make 12 yards of cloth plus 14 bushels of corn.

If A specialises in cloth and B in corn, then 16 days' labour will produce 16 yards of cloth plus 12 bushels of corn.

Thus by specialization they both gain four yards of cloth and loose two bushels of ~~wheat~~ corn; but it is supposed that their gain is greater than their loss.

2) Relative Advantage:-

A has a relative advantage in one commodity only and not in both as in the previous example.

In A 8 days' labour will make 8 yards of cloth or 6 bushels of corn.

In B 8 days' labour will make 4 yards of cloth or 8 bushels of corn.

If each produces for itself then 16 days' labour will make 12 yards of cloth plus 14 bushels of corn.

If A specializes in cloth and B in corn then 16 days' labour will make 16 yards of cloth plus 16 bushels of corn.

By specialization they both gain 4 yards of cloth. By the law of comparative cost, as in the previous example, it would be to the interest of both for A to confine itself to the production of cloth and B to the production of corn.

Examples A and B are illustrations of the theory of Comparative Cost. We have now to enquire with reference to

these examples into the conditions which determine the real ratio of exchange which lies within the limits set by comparative cost. What are the terms on which the exchange of cloth and corn will take place? How will the gain resulting from the foreign trade be divided among the parties to the exchange, namely, country A and country B?

According to the first example, A must obtain at least 4 bushels of corn from B for her 4 yards of cloth; otherwise it will pay her to produce the corn herself. B must obtain at least 4 yards of cloth from A for her 6 bushels of corn; otherwise it will pay her to produce the cloth herself. The limits imposed by Comparative Costs are 4 yards of cloth to 4 bushels of corn and 6 bushels of corn. The ratio of exchange must lie anywhere between them, the exact point being determined by reciprocal demand. By A's demand to B's corn and B's for A's cloth.

According to the second example, A must obtain at least 8 bushels of corn from B for her 8 yards of cloth. B must obtain at least 4 yards of cloth from A for her 8 bushels of corn. The limits imposed by comparative cost are 8 bushels of corn to 4 yards of cloth and 8 yards of cloth. As in the previous example, the ratio of exchange must be anywhere between them, the exact point being determined by reciprocal demand. By A's demand for B's corn and B's demand for A's cloth.